WEEKLY ANALYSIS

M. Alain Freymond—Associé & CIO

PROSPECTS AND STRATEGIES I INTERNATIONAL BONDS

Interest rate markets flare up as price and inflation soar. The yield curve adjustments are already very significant. Sustained, widespread tension in European rates. New opportunities in the dollar zone in particular.

Points clés

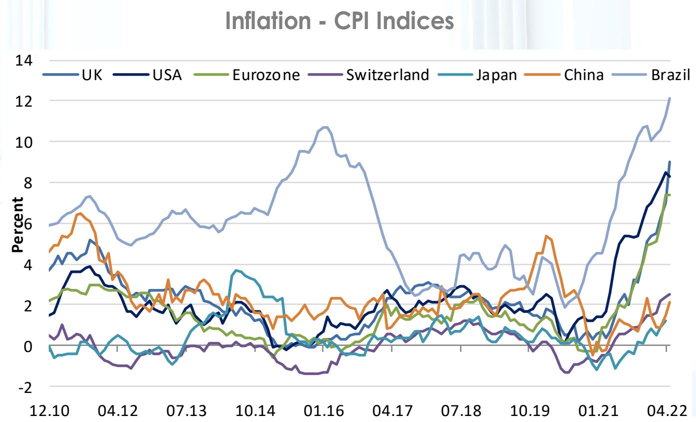
- Net deterioration of the economic prospects 2022
- Intesrest rate markets flare up as prices and inflation soar
- Opportunities arise for short-term bonds
- Sustained, widespread tension in European rates
- Sterling yields may stabilize
- Ten-year yields return to positive territory in Japan
- Repositionning in favor of dollar zone bonds

Net deterioration of the economic prospects 2022

The intensification of the conflict in Ukraine and the increase in tensions between Russia and Europe are rekindling many uncertainties and risks of the conflict getting out of hand and spreading. Consequently, the rise in energy and commodity prices seen in recent weeks could well prove to be long-lasting. A global supply shock and a major destabilisation of the world's commodity markets is now a credible possibility that should be considered at its true level of probability. The effects in 2022 of such a shock would be particularly damaging, as inflation is already at its highest level in 40 years in the US (+8.3%) and since October 2008 in Switzerland (+2.5%). The growth outlook for the coming months must therefore be revised because of the significant risks of a decline in household purchasing power. The downturn in private consumption would then materialise at the same time as the contraction in public spending to support the economy in connection with the health crisis. The normalisation of central banks' monetary policies, and in particular that of the US Federal Reserve, is thus taking place in this challenging context and could significantly increase the already high risks of a slowdown, or even a "hard landing", of the world economy. Stagflation is already looming, which could be more difficult for central banks to manage if the world economy were to enter a recession in Q2 2022 already.

Interest rate markets flare up as prices and inflation soar

The end of the Fed's liquidity injections coincided with the resumption of the upward trend in US rates in Q1 2022. Inflation measures that were already particularly worrying at the end of last year also contributed to the consideration of existing imbalances between bond supply and demand at the beginning of the year. The rise in ten-year US Treasury rates from 1.5% to 2% between 1 January and 15 February occurred against the backdrop of a reduction in the Fed's monthly injections of around 100 billion per month and continued inflationary pressures, with a +0.6% rise in the January CPI, pushing up year-on-year inflation from +7% to +7.5%. Russia's invasion of Ukraine on 24 February was not immediately perceived as inflationary, but a few days later, rising gas and oil prices clearly rang investors's bell.



Sources: BBGI Group SA

The surge in energy prices thus quickly fired up bond markets and yield curves in virtually all currencies. After an initial yield curve adjustment shock of about 50 basis points, the adjustments accelerated in April/May. Yield curves rose further as pressure on various inflation measures continued. Ten-year U.S. Treasury yields were still rising quite strongly from 2.33% to 3.2%, while five-year rates were also advancing from 2.45% to 3% and were certainly reaching a likely stabilization level.